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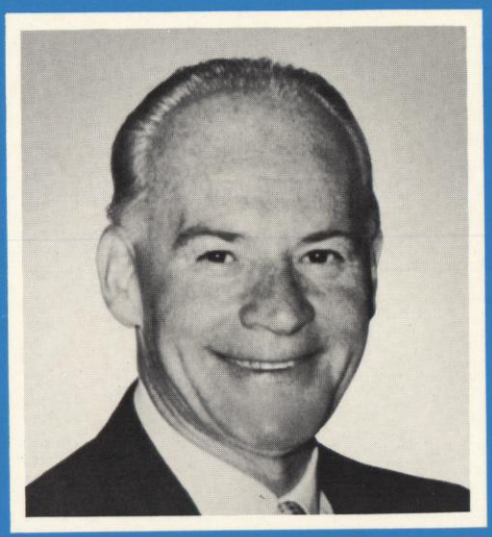
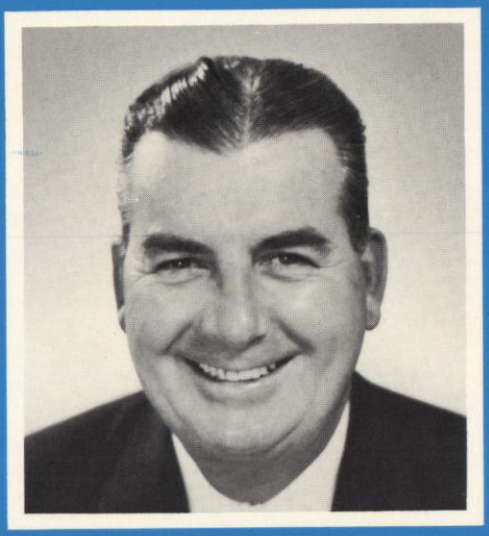
ANNUAL REPORT 1964

Annual Report 1964/National Tea Co.



GEORGE C. METCALF
Chairman of the Company



NORMAN A. STEPELTON
President and Chief Executive Officer

Notes to Consolidated Financial Statements

LONG-TERM DEBT

Aggregate maturities and sinking fund requirements under long-term loan agreements, exclusive of minor installments due on store building mortgage loans are $1,566,000 in 1965 and 1966, $6,566,000 in 1967 and $1,566,000 in 1968 and 1969.

DIVIDEND RESTRICTION

Under the terms of the indenture securing the 5% Sinking Fund Debentures, $25,721,728 of earned surplus is restricted as to the payment of cash dividends on and the purchase of common shares at January 2, 1965. In addition the company must maintain a current ratio of consolidated current assets to consolidated current liabilities as defined in the indenture of at least 2 to 1. As of January 2, 1965, the current ratio as defined was 2.4 to 1.

STOCK OPTIONS

As of January 2, 1965, there were 9,620 unissued common shares reserved for employee stock options under the 1957 Plan. Each option expires five years after grant, but not later than January 1, 1966. 20% of the shares covered by each option becomes exercisable ten months after grant of the option and an additional 20% becomes exercisable each year thereafter.

As of January 2, 1965, there were 90,600 unissued common shares reserved for options under the 1959 Plan. Each option under this Plan expires four years after date of grant, but not later than January 1, 1968. These options may be exercised in whole or in part at any time from eighteen months following the date of grant until expiration of the option.

Under both Plans, at January 2, 1965, options for 100,220 shares, of which 9,170 were exercisable, were outstanding at prices ranging from $13.875 to $18.88 per share.

LEGAL PROCEEDINGS

In March, 1959, the Federal Trade Commission filed a complaint against the company alleging that several acquisitions of additional retail grocery stores violated Section 5 of the Federal Trade Commission Act and Section 7 of the Clayton Act. On April 8, 1963, the Hearing Examiner filed his initial decision dismissing the complaint. The matter is now on appeal to the full Commission. Nothing has occurred in the proceeding to date to indicate that there will be any adverse effect on the company as a result of this complaint.

LEASE COMMITMENTS

At January 2, 1965, the company and its subsidiaries had 756 leases expiring more than three years after that date (some of which contain percentage rental clauses) with minimum annual rentals amounting to approximately $18,500,000 exclusive of taxes, insurance and maintenance payable by the lessee. Of this amount, approximately 58% applies to leases expiring within 10 years.

Auditors' Opinion

ARTHUR ANDERSEN & CO.

120 SOUTH LA SALLE STREET

CHICAGO, ILLINOIS 60603

TO THE SHAREHOLDERS,
NATIONAL TEA CO.:

We have examined the consolidated balance sheet of NATIONAL TEA CO. (an Illinois corporation) AND SUBSIDIARIES as of January 2, 1965, and the related statements of consolidated income and surplus and source and disposition of funds for the fifty-three weeks then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated balance sheet, statements of income and surplus and source and disposition of funds present fairly the financial position of National Tea Co. and Subsidiaries as of January 2, 1965, and the results of their operations and the sources and disposition of funds for the fifty-three weeks then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding fifty-two week period.

ARTHUR ANDERSEN & CO.

Chicago, Illinois
February 12, 1965.

Consolidated Statement of Source and Disposition of Funds

	FISCAL YEAR ENDED	
	January 2, 1965 *(53 weeks)*	December 28, 1963 *(52 weeks)*
SOURCE OF FUNDS:		
Net income and (in 1963) special credit	$10,640,294	$ 9,205,256
Non-cash items deducted in arriving at net income:		
Depreciation and amortization	13,052,907	12,224,973
Increase in reserve for self-insurance	140,000	—
Deferred Federal income taxes	233,000	452,000
Total funds from earnings and special credit	$24,066,201	$21,882,229
Proceeds from:		
Mortgage loans on store buildings	—	230,000
Sale of common shares to optionees	29,937	13,861
Other sources, net	572,122	1,350,271
Total	$24,668,260	$23,476,361
DISPOSITION OF FUNDS:		
Cash dividends to shareholders	$ 6,812,905	$ 6,820,474
Net additions to property and equipment	11,134,502	16,475,362
Retirement of long-term debt	1,625,393	1,306,109
Acquisition of treasury shares	791,378	—
Increase or (decrease) in working capital	4,304,082	(1,125,584)
Total	$24,668,260	$23,476,361

The accompanying notes are an integral part of these statements.

Statements of Consolidated Income and Surplus
National Tea Co. & Subsidiaries

	FISCAL YEAR ENDED	
INCOME:	January 2, 1965 *(53 weeks)*	December 28, 1963 *(52 weeks)*
SALES	$1,122,515,806	$1,056,919,339
COSTS AND EXPENSES:		
Cost of sales and expenses	$1,065,781,950	$1,005,652,539
Depreciation and amortization	13,052,907	12,224,973
Rent	21,245,942	20,026,900
Interest	1,467,713	1,606,381
Profit sharing	621,000	518,000
Federal income taxes	9,706,000	8,526,000
	$1,111,875,512	$1,048,554,793
NET INCOME	$ 10,640,294	$ 8,364,546
SPECIAL CREDIT—arising from sale of subsidiaries, net of Federal income taxes	—	840,710
NET INCOME AND SPECIAL CREDIT	$ 10,640,294	$ 9,205,256

EARNED SURPLUS:	
BALANCE AT DECEMBER 28, 1963	$ 54,550,611
ADD (DEDUCT):	
Net income	10,640,294
Dividends ($.80 per share)	(6,812,905)
BALANCE AT JANUARY 2, 1965	$ 58,378,000

PAID-IN SURPLUS:	
BALANCE AT DECEMBER 28, 1963	$ 27,505,229
Excess of principal amount of debentures retired over par value of common shares issued in conversion	1,576
Excess of proceeds over par value of common shares sold to officers and employees under stock option plans	21,805
BALANCE AT JANUARY 2, 1965	$ 27,528,610

The accompanying notes are an integral part of these statements.

& Subsidiaries

Liabilities

	January 2, 1965	December 28, 1963
CURRENT LIABILITIES:		
Current maturities of long-term debt	$ 1,566,000	$ 1,266,000
Accounts payable	37,098,798	37,165,731
Accrued liabilities	8,339,602	7,892,496
Federal income taxes	4,393,624	3,869,705
Total current liabilities	$ 51,398,024	$ 50,193,932
LONG-TERM DEBT:		
Installment mortgage notes on store buildings	$ 914,630	$ 972,023
3½% promissory notes, due serially to 1969	344,000	430,000
4% promissory notes, due serially to 1973	9,800,000	10,800,000
5% sinking fund debentures, due 1977	8,640,000	9,120,000
4¾% term note, due 1967	5,000,000	5,000,000
3½% subordinated debentures, due 1980 (convertible into 324,125 common shares through November 1, 1965)	6,207,000	6,209,000
	$ 30,905,630	$ 32,531,023
OTHER LIABILITIES:		
Deferred Federal income taxes	$ 5,885,000	$ 5,652,000
Self-insurance	390,000	250,000
	$ 6,275,000	$ 5,902,000
SHAREHOLDERS' INVESTMENT:		
Common shares, $4 par value, authorized 10,000,000 shares; issued 8,527,952 shares (8,525,815 in 1963)	$ 34,111,808	$ 34,103,260
Paid-in surplus	27,528,610	27,505,229
Earned surplus	58,378,000	54,550,611
	$120,018,418	$116,159,100
Less cost of 44,800 common shares in treasury	791,378	—
	$119,227,040	$116,159,100
	$207,805,694	$204,786,055

an integral part of this statement.

1964 Consolidated Balance Sheet / National Tea Co.

Assets

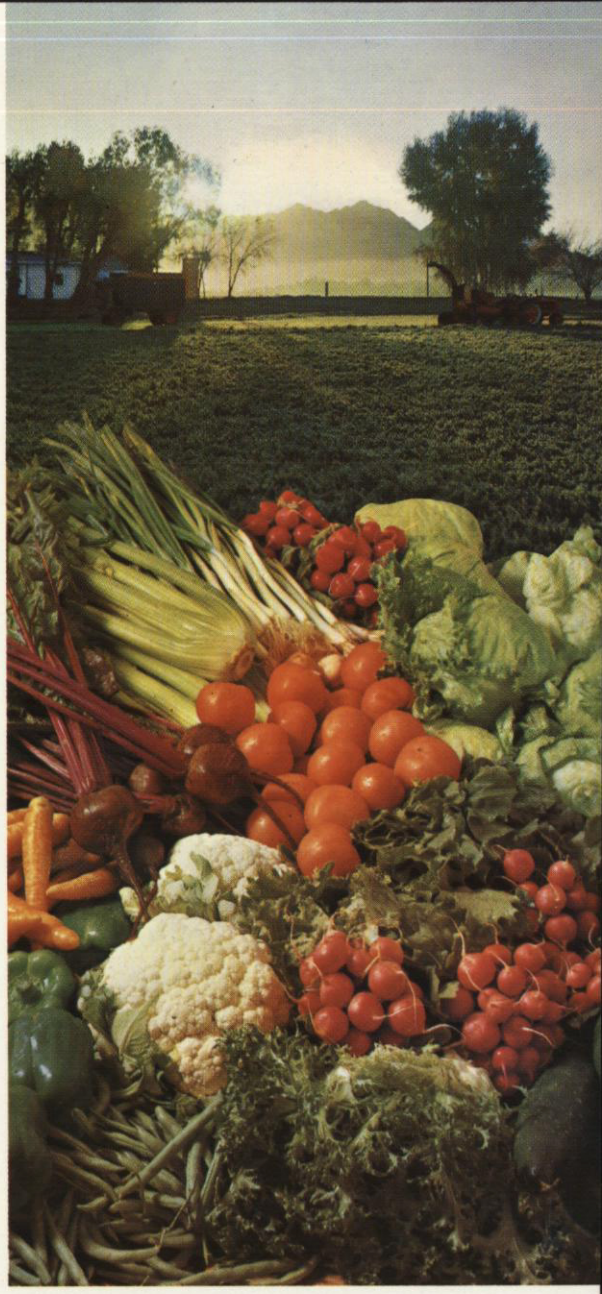
	January 2, 1965	December 28, 1963
CURRENT ASSETS:		
Cash	$ 15,936,311	$ 15,766,314
Accounts receivable	8,011,763	7,560,059
Inventories, at lower of average cost or market	82,195,058	80,574,874
Prepaid expenses, etc.	5,303,102	3,717,802
Real estate in process of development and sale	1,680,989	—
Total current assets	$113,127,223	$107,619,049
OTHER ASSETS	$ 1,691,373	$ 2,261,503
PROPERTY AND EQUIPMENT, at cost:		
Land	$ 2,778,421	$ 2,651,880
Buildings	9,384,471	9,255,028
Fixtures and equipment	108,325,841	104,888,135
Reserves for depreciation	(51,003,497)	(46,318,566)
Leasehold improvements, less amortization	22,573,070	23,500,234
	$ 92,058,306	$ 93,976,711
Unamortized excess of cost of investment in divisions and subsidiaries over underlying book values at dates of acquisition	928,792	928,792
	$ 92,987,098	$ 94,905,503
	$207,805,694	$204,786,055

The accompanying notes are

housewife the fullest choice in grade and price.

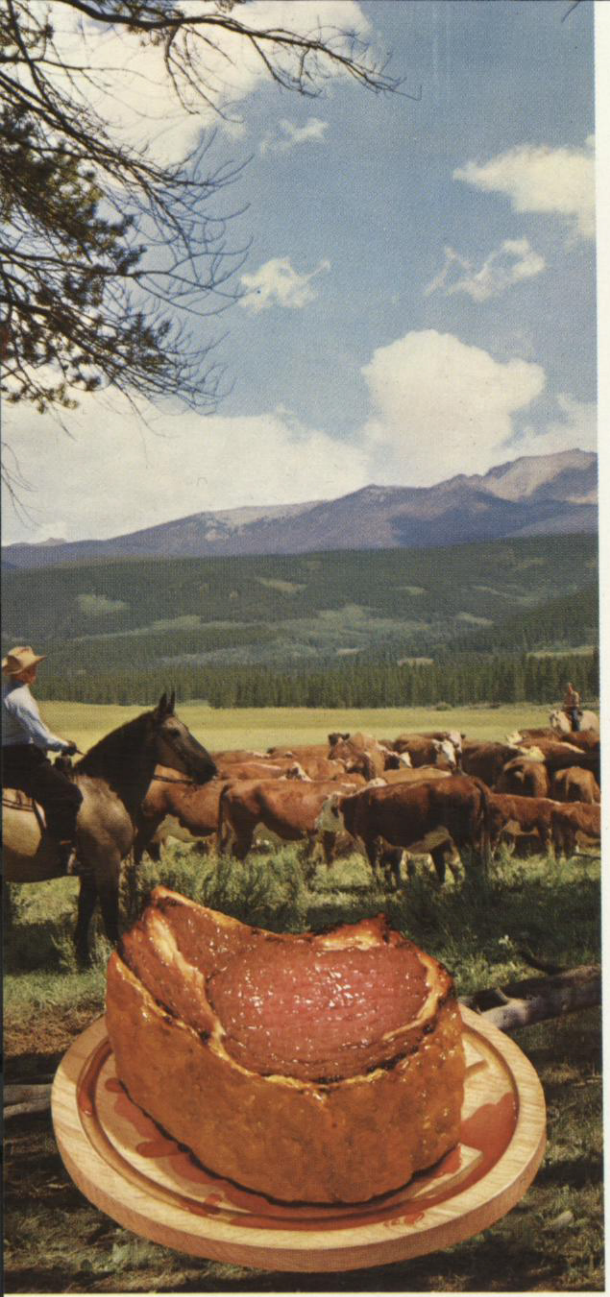
And, National's own private label products have achieved a reputation for consistent quality. National's own Quality Control Laboratory tests each item regularly, and as rigorously as they test other brands before accepting them for distribution.

Because of this, National's private label products have grown greatly in popularity, and have become a hallmark of National quality.



Dawn Dew Fresh Produce

National "follows the sun" to bring the customer the finest in fresh fruits and vegetables. Wherever a new crop nears ripening, you'll find a National produce buyer. These men are familiar with the nation's finest growers, and have specialized knowledge of each particular crop and growing area. The result is the best quality produce, which a flexible buying system obtains at the best possible price. And, an efficient distribution system assures their "Dawn Dew Fresh" delivery at every National Food Store.



Corn-fed Beef

To bring its customers the finest in meats, National Food Stores feature genuine Colorado Corn-Fed Beef. These cattle are raised on lush grasses and clear mountain water. Corn feeding for many months results in beef that is noted for its natural tenderness, fine marbling, and delicious flavor. National's Value-Way Trimming assures the customer of the greatest economy in every cut. Each day, more and more people discover and choose Colorado Corn-Fed Beef—building National's reputation for quality.

National's Own Products

Alongside the full line of famous, nationally advertised brands to be found in every National Food Store is a wide selection of National's own private labels: Top Taste, Top Treat, Orchard Fresh, Garden Fresh, So Fresh, Easy Life, Hillside, Hazel and Natco brands.

All of these National private labels were created by demand, and pass along to the consumer a quality and economy not found among existing brands. They are not intended to compete with advertised brands as such, but to offer the

Chicago Division. Mr. F. E. Linquist was also promoted to Regional Vice President and will be responsible for several retail divisions.

Mr. R. N. Brown, Division Manager of the New Orleans Division, has been elected a Vice President of the parent Company.

Mr. J. Chilcutt has been promoted to Division Manager in Denver, and Mr. R. Petersen to Division Manager in Sioux City.

In addition to these executive changes, there have been numerous other promotions throughout the Company. These promotions from within the Company were made possible by our "bench strength," the result of concentrated organizational development efforts over the last few years. Training programs at all levels are preparing our younger employees for greater responsibilities ahead, assuring the future strength and growth of the Company.

Other Highlights

Despite the growth of sales and earnings in 1964, operations were not without serious problems. There was no evidence of any lessening of the intense competition which has been a part of the retail food picture for many years.

In common with other segments of the industry, we suffered three work stoppages. Fortunately, with a background of excellent employee relations over the years, these stoppages were of reasonably short duration and did not materially affect overall sales or earnings.

Our Company has, over the years, enjoyed generally fine relationships with the many union organizations that we deal with. In our experience with the unions, we have found a willingness to work out mutually satisfactory solutions to problems regardless of the time or effort involved.

Our employee relations are characterized by the same loyalty and spirit of cooperation that has so long been a mainstay of the Company. The achievements of the Company in 1964 can be traced directly to the efforts of our employees, and we take this opportunity to thank each one for his contribution to the overall result.

Outlook for 1965

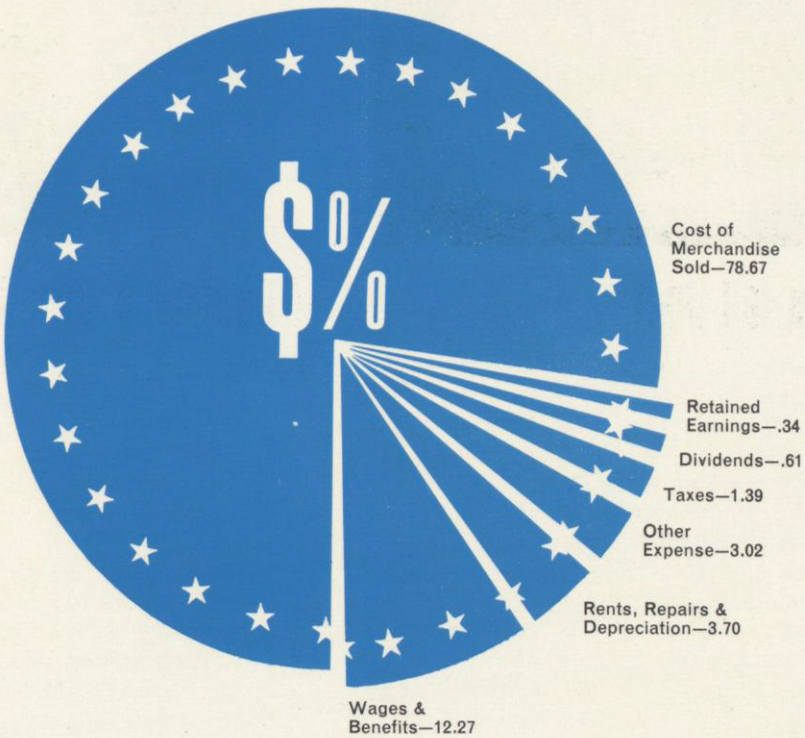
We believe that the Company has a great potential for additional growth in sales and earnings in 1965. Plans have already been made for our new store and remodeling program, our warehouse improvement program, various merchandising programs and additional new facilities. We have a fine team of enthusiastic employees who have the capacity to carry out these plans successfully. These people have demonstrated the necessary flexibility to cope with problems that cannot be planned for in advance. We believe we have every reason to express confident optimism over prospects for significant additional progress in 1965.

N. A. Stepelton

N. A. Stepelton
President

Chicago, Illinois
February 12, 1965

1964 Distribution of the Sales Dollar



The paramount aim of our store improvement program is to increase the excellence of our customer service. The goals of our warehouse and plant improvement program are to achieve even higher quality of product and to lower our cost of distribution. We made a start on several major improvements in 1964, although the full impact will not be realized until 1965 or later.

An addition to the Milwaukee warehouse was completed this last year, facilitating the handling of fresh produce and frozen foods and resulting in better quality of product in our stores and a lower cost of handling in the warehouse.

Ground was broken for a new distribution center in St. Louis that is expected to be in operation by August, 1965. This modern center, featuring the latest developments in merchandise handling, will be a vast improvement over the existing facility and will greatly increase the efficiency of handling all commodities in the St. Louis Division.

During the latter part of 1964, a new plant was opened in the Chicago area for grading and packaging *So Fresh* potatoes and onions. In full operation, this new central Chicago facility will have the capacity to supply higher quality bagged potatoes and onions for several Company Divisions.

In 1964, the Wm. H. Heinemann bakery plant gave way to a Milwaukee superhighway project, but it was relocated in a larger, one-story building, and modernized in the process. The enlarged plant can serve a substantially larger number of stores, and these fine bakery products will soon be appearing in additional National Food Stores in the Wisconsin area.

The combined store, warehouse and plant improvement program, together with other necessary replacements and additions, cost an aggregate $11,134,502, net of sales of fixed assets. We expect to reap significant benefits from these expenditures in the years ahead.

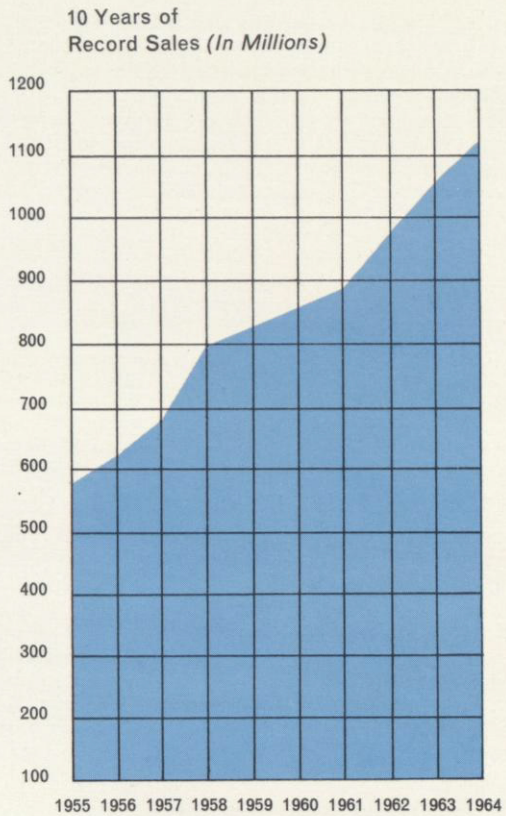
Organization Changes

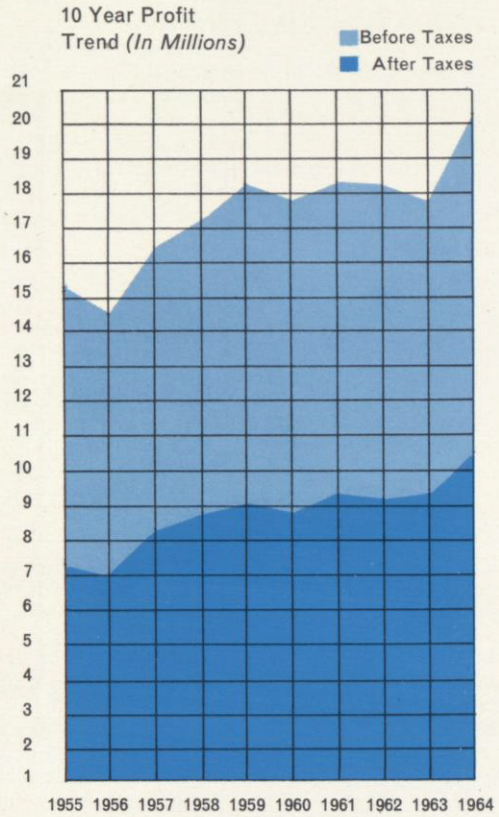
Mr. Harley V. McNamara will complete 20 years of service as a Director of National Tea Co. on March 21, 1965. During that time he has contributed greatly to the development of the Company, first as Executive Vice President, then President, and more recently as Consultant. Mr. McNamara is exceptionally well-known and highly regarded throughout the food industry, making his contribution to our Company even more effective. Mr. McNamara does not wish to be renominated to the Board of Directors this year, although he has consented to remain as Consultant to the Company. In recognition of his long and valuable service to the Company, Mr. McNamara has been named Honorary Chairman of the Company.

All of us in the Company were saddened by the untimely death on January 1, 1965 of Mr. J. E. O'Berry, who was Vice President in charge of Grocery Merchandising.

Mr. G. A. Seeberg, formerly Sales Manager of the Chicago Division, has been elected a Vice President of the Company and will be in charge of Grocery Merchandising, Advertising and Sales Promotion.

Mr. J. E. Laughlin was promoted to Regional Vice President and will continue to manage the





President's Letter

To Our Shareholders:

1964 was a year of exceptional growth and progress for National Tea Co. A new sales record of $1,122,515,806 —a 6.2% increase over 1963—was achieved. While 1964 was a 53-week year, our sales increase amounted to 4.3% even without the additional week—a notable improvement considering there were no acquisitions during the year and the number of stores in operation actually declined slightly.

Average sales per store in 1964 were $1,153,664, also a new high. On a weekly average basis, which eliminates the effect of the extra week in 1964, the increase in average sales per supermarket was 5.6%.

On a per share basis, earnings for 1964 were $1.25, based on the average of 8,504,000 shares outstanding. In 1963, the per share earnings of $1.17 included a non-recurring special credit of $840,710 and were based upon an average of only 7,844,000 shares outstanding.

Financial Position

Significant improvements were made in the financial condition of the Company. Working capital was increased during the year by $4,304,082, and the current ratio as defined under the indenture securing the 5% Sinking Fund Debentures was 2.4 to 1—an improvement over last year's 2.3 to 1 and well above the required 2.0 to 1.

The non-current portion of our long-term debt was reduced by $1,625,393, and 44,800 Common Shares of the Company were purchased for the Treasury at a cost of $791,378. These results were accomplished without any additional borrowing, even on a short-term basis, at any time during the year.

The shares acquired for the Treasury may be used for future expansion, issuance of shares pursuant to the provisions of the stock option plan or for other purposes as authorized by the Board of Directors.

Improvements to Properties

Noteworthy progress was made in our continuing program to operate stores that the Company and shareholders can be proud of and that continue to make shopping a pleasant experience for our customers. As part of this program, 37 stores were opened during the year—24 new locations and 13 relocations. These stores averaged 16,044 square feet in size.

During the year, 61 stores were remodeled, ranging from the renovation of a single department to major projects involving store enlargement and replacement of fixtures and equipment—for all practical purposes a brand new store. Generally, these remodeling projects were undertaken in proven locations where the sales potential had outstripped the original capacity of the store, or where an older location showed promise of a "second generation" of customer service. Through the 1964 remodeling and new store program, it is believed that the overall physical store plant was greatly improved during the year.

During the same period, 50 stores were closed. Some were replaced by new stores while other locations, rendered obsolete by the changing face of our cities, were permanently closed.

Financial Highlights

FOR THE FISCAL YEAR ENDED:	January 2, 1965 *(53 weeks)*	December 28, 1963	December 29, 1962	December 30, 1961	December 31, 1960
Sales	$1,122,515,806	$1,056,919,339	$979,049,258	$888,852,905	$855,840,888
Income before Federal income taxes	20,346,294	16,890,546	18,123,011	19,464,514	17,861,825
Federal income taxes	9,706,000	8,526,000	9,005,000	10,150,000	9,200,000
Special credit, net of taxes	—	840,710	—	—	—
Net income and special credit.	$ 10,640,294	$ 9,205,256	$ 9,118,011	$ 9,314,514	$ 8,661,825
Percent to sales	.95%	.87%	.93%	1.05%	1.01%
Per share*	1.25	1.17	1.28	1.31	1.23
Dividends per share	.80	.80	.80	.80	.80
AT YEAR END:					
Working capital	$ 61,729,199	$ 57,425,117	$ 58,550,701	$ 42,422,922	$ 43,376,122
Property and equipment	92,987,098	94,905,503	92,242,459	76,703,420	71,579,665
Long-term debt	30,905,630	32,531,023	33,607,132	29,628,922	31,104,000
Shareholders' investment	119,227,040	116,159,100	113,783,457	87,039,714	82,140,961
Shares outstanding	8,483,152	8,525,815	7,161,942	7,133,505	7,053,722
Book value per share	14.05	13.62	13.35	12.20	11.65
Supermarkets in operation	973	986	985	897	897

*Based upon average of number of shares outstanding at beginning and end of year.

Directors

NORBERT L. CHAPLICKI
Vice President

JOHN F. CUNEO
President of The Cuneo Press, Inc.

EDWARD L. JONES
Secretary of George Weston Limited

HARLEY V. McNAMARA
Consultant

RICHARD G. MEECH
Vice President, Secretary and Treasurer of Loblaw Groceterias Co., Limited

GEORGE C. METCALF
Chairman of the Company and President of Loblaw Groceterias, Co., Limited

NORMAN A. STEPELTON
President and Chief Executive Officer

CLAUDE H. WEBSTER
Executive Vice President

W. GARFIELD WESTON
Chairman of the Board of George Weston Limited

Transfer Agents

THE FIRST NATIONAL
BANK OF CHICAGO
Chicago, Illinois

THE CHASE MANHATTAN BANK
New York, New York

Registrars

CONTINENTAL ILLINOIS NATIONAL
BANK & TRUST COMPANY OF CHICAGO
Chicago, Illinois

CHEMICAL BANK NEW YORK
TRUST COMPANY
New York, New York

Transfer and Paying Agents

3½% Debentures
CHEMICAL BANK NEW YORK
TRUST COMPANY
New York, New York

5% Debentures
MORGAN GUARANTY TRUST COMPANY
New York, New York

Officers

GEORGE C. METCALF
Chairman of the Company

NORMAN A. STEPELTON
President and Chief Executive Officer

CLAUDE H. WEBSTER
Executive Vice President

NORBERT L. CHAPLICKI
Vice President

GEORGE E. HOUSTON
Vice President

HENRY H. NIEMANN
Vice President

HAROLD L. WILKENS
Vice President

J. E. LAUGHLIN
Vice President

FRANK E. LINQUIST
Vice President

NAT MALT
Vice President

WILLIAM J. LEDERER
Vice President and General Counsel

J. P. QUIRK
Vice President

H. L. MARTIN
Vice President

RODGERS N. BROWN
Vice President

GORDON A. SEEBERG
Vice President

ALLAN WILSON, JR.
Secretary-Treasurer

E. C. WINLAND
Comptroller

Home Office

1000 N. CROSBY STREET
CHICAGO, ILLINOIS 60680

Divisional Offices and Warehouses

• CHICAGO • MINNEAPOLIS • MILWAUKEE
• INDIANAPOLIS • DETROIT • ST. LOUIS
• NEW ORLEANS • MEMPHIS • DAVENPORT
• DENVER • SIOUX CITY • YOUNGSTOWN

Food Stores Serving the States of

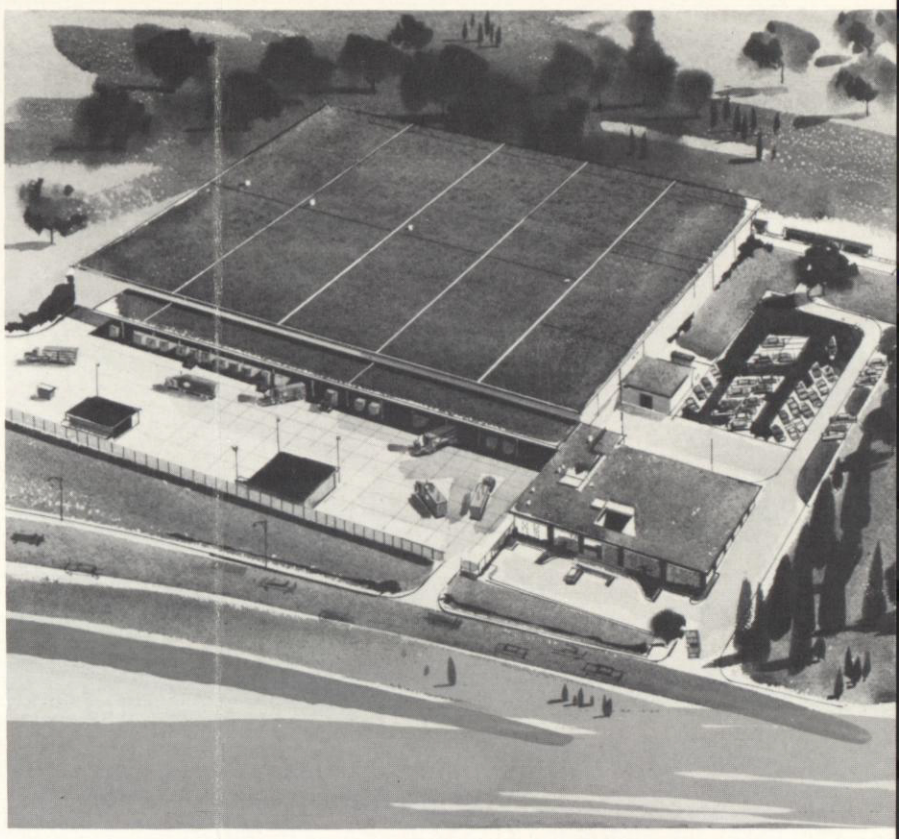
• ALABAMA • ARKANSAS • COLORADO
• ILLINOIS • INDIANA • IOWA • LOUISIANA
• MICHIGAN • MINNESOTA • MISSISSIPPI
• MISSOURI • NEBRASKA • NORTH DAKOTA
• OHIO • PENNSYLVANIA • SOUTH DAKOTA
• TENNESSEE • WEST VIRGINIA • WISCONSIN
• WYOMING

New St. Louis Food Distribution Center

Marking National Food Stores' growth is this new $3,000,000 Food Distribution Center near St. Louis, Missouri. A complex of buildings covering 346,000 square feet on a 25 acre site, the facilities include dock space for 34 trucks, space for 22 railroad cars inside the warehouse, and two acres of refrigerated storage area.

In addition to a grocery storage capacity of 14,783,000 pounds, the warehouse has refrigerated storage facilities for 2,256,000 pounds of frozen foods, 1,186,000 pounds of meat and poultry, 930,000 pounds of produce, and banana ripening rooms with a 235,000 pound capacity.

One of the largest and finest buildings of its type in the country, the St. Louis Distribution Center follows the completion last year of a similar facility in New Orleans. When completed in 1965, this new Food Center will anchor National's operation in central Missouri and Southern Illinois, and provide for strong expansion in this area.



New Orleans Distribution Center

Management Development Program

Today, throughout National's 14 Divisions, specially selected people are studying in training schools, workshops, clinics and universities under National's Management Development Program.

It is natural that we look within for leadership—for within are the people who now make National strong—through ability, sincerity, and dedication.

The results of the Management Development Program are already visible in National's increased strength and leadership in the food field . . . a leadership that means a great and growing future.

Once again, National demonstrates that it is more than just an American phenomenon in corporate success. It is people. And, National puts into practice the principle that first, last and always, its obligation is to people: the people who serve it; the people who invest in it; the people it serves.

★ ★ ★

NATIONAL

TEA CO.